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Wolfgang Crinius and Günter Weinert

Slow Recovery in World Trade

World trade is currently undergoing a period of pronounced weakness. Following average growth of a good 10% in 1997, it increased by only around 4% last year. Yet even this increase was due to the high level at the start of the year; during the course of last year it virtually stagnated. This year, however, recovery is likely to assert itself once more.

World trade developments are a reflection of the state of the global economy. Last year, world production grew at a rate of just under 2%, only half the previous year's level, and there was largely stagnation during the course of the year. This was primarily a result of the financial and economic crises in East Asia which erupted in the second half of 1997, and the turbulence into which Russia and finally Latin America were drawn last summer. During the course of the year the crises spread via international financial markets and trade flows to other emerging economies in particular. Many commodity-exporting countries were additionally affected by the ongoing decline in dollar-based commodity prices. This is particularly true of the oil exporters, but suppliers of other commodities also suffered. Furthermore, the deep recession in Japan continued. As a result of the crises, there was a slump in economic activity in countries which together account for two fifths of total world production.

The global economy was supported by western Europe and the USA. However, the winter months brought a marked slowdown in expansion in western Europe, too, primarily as a result of significantly weakening foreign demand. In the USA on the other hand, despite a temporary decline in exports last summer, aggregate output continued its strong expansion thanks to frenzied domestic demand. Swift reactions on the part of the central bank played an important role in maintaining this expansion when last autumn's turbulence threatened to spread to the international financial markets. The marked reduction

in key interest rates prevented a further imminent decline in share prices and the emergence of a credit squeeze.

With the private households' savings rate having fallen to zero, the momentum of domestic demand will slacken off this year despite the expansive monetary policy, especially as there is likely to be a renewed increase in key interest rates to counteract the threat of an overheating economy. As far as western Europe is concerned, in view of the fact that external dampening effects are on the wane, and given the more favourable monetary conditions currently prevailing, it will probably enjoy a marked recovery during the course of this year; a brisk continuation of this recovery can be expected for next year.

Regional economic developments this year will thus be less divergent than in 1998, if only because of the stabilisation and gradual recovery of production – of which there are an increasing number of signs – in the crisis economies of Southeast Asia. Next year will see a consolidation of the upward trend. However, growth remains well below the rates which were typical for this region in pre-crisis years. Recovery in the crisis economies of Southeast Asia is all the more probable given that Japan also appears to be coming out of recession. The strong economic impulses emanating from Japanese fiscal policy this year should gradually bolster domestic demand.

Although the decline in production in Latin America will continue for the time being, here, too, renewed impetus is likely to make itself felt in the latter part of the year. It has been assumed for forecasting purposes that the exchange rates of major currencies against the dollar will remain largely constant and that there will be a renewed increase in commodity prices (see Table 1, Figure 1). This does not become apparent in the annual average changes until next year; this year is still dominated by the 1998 overhang.

Foreign trade developments also differed strongly between individual regions and countries during the

* Hamburg Institute for Economic Research (HWWA), Hamburg, Germany. This paper is based on the results of the Working Group on Foreign Trade of the Association of European Conjunction Institutes (AIECE) from spring 1999. The working group comprises the following members: COE Chambre de Commerce et d'Industrie de Paris, Paris; CPB Netherlands Bureau for Economic Policy Analysis, The Hague; DULBEA Département d'Économie Appliquée de l'Université Libre de Bruxelles, Brussels; FTRI Foreign Trade Research Institute, Warsaw; Hamburg Institute for Economic Research (HWWA), Hamburg; INSEE Institut National de la Statistique et des Études Économiques, Paris; ISAE Istituto di Studie e Analisi Economica, Rome; KOPINT Economic Research, Marketing and Computing Co., Budapest.

Table 1
Assumptions and Forecasts

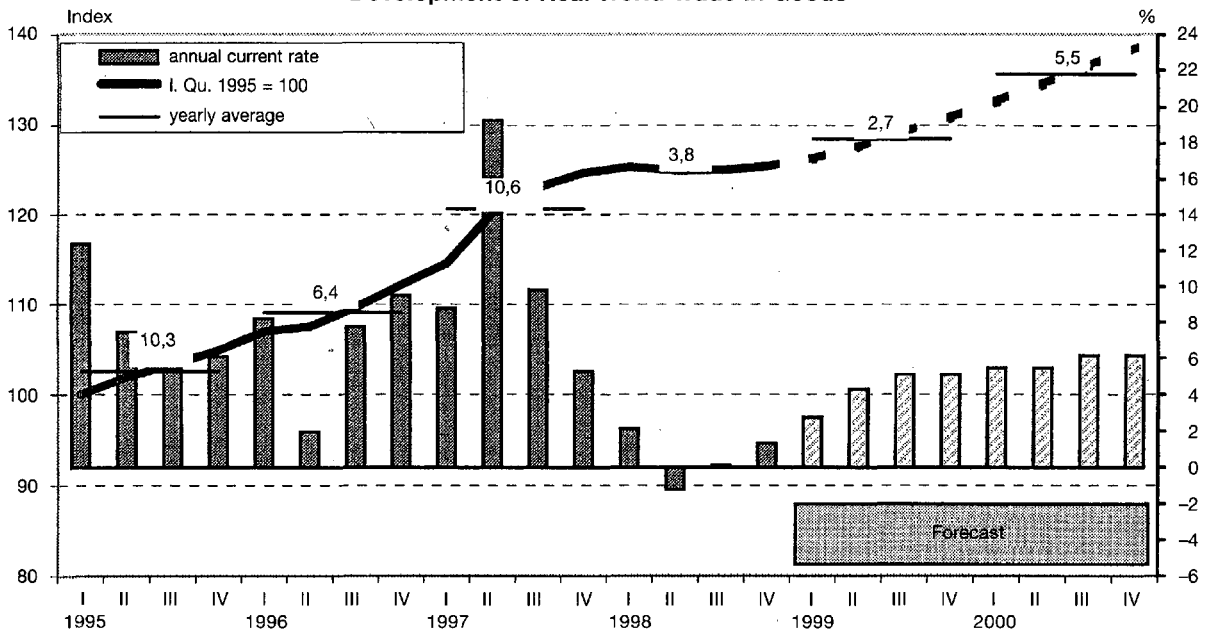
	1998	1999	2000
Real gross domestic product (annual rate of change in %)			
Industrialised countries	2.4	1 $\frac{3}{4}$	2
Western Europe	2.8	1 $\frac{1}{2}$	2 $\frac{1}{4}$
USA	3.9	3 $\frac{1}{4}$	2 $\frac{1}{2}$
Japan	-2.8	-1 $\frac{1}{2}$	-
Exchange rates			
DM/dollar	1.76	1.75	1.70
Yen/dollar	130.9	117	117
World trade volume, goods	3 $\frac{3}{4}$	2 $\frac{3}{4}$	5 $\frac{1}{2}$
World trade prices, total on US dollar basis (year-on-year change in %)	-5 $\frac{1}{4}$	-1 $\frac{1}{4}$	2 $\frac{1}{4}$
Crude oil, Brent	-31.0	0.0	15.7
Other commodities			
(HWWA-Index on dollar basis)	-13.7	-7	7
Manufactured goods	-2.5	-1	$\frac{1}{4}$
World trade prices, total (in national currencies)	-1	-2	1 $\frac{1}{4}$

course of last year. This is particularly true of imports which declined drastically in the crisis countries in the wake of a sharp fall in demand. In the first half of the year in particular there was a renewed strong fall in imports in the emerging economies of Southeast Asia, partly due to the extensive depletion of existing stockpiles. Furthermore, there was a considerable decline in Japanese imports as a result of the recession. These developments were compounded by the extensive integration between the region's

economies. While the decline in Asia's import volumes slowed down in the second half of the year, other regions ran into economic crisis. Russia's imports declined by more than 50% in just a few months, and there was a considerable fall in Brazil, too. In contrast, there was a marked increase in imports into western Europe in particular, albeit slowing down towards the end of the year. The increase in imports by the USA actually accelerated during the second half of the year; with a double-digit growth rate US imports were supporting the world economy.

As differences between economic developments in the various countries and regions of the world diminish, so too will there be a greater degree of convergence in the way imports develop. While import growth in the USA will slacken off as the economy heads for a 'soft landing', it will pick up again in western Europe. In Japan, imports will merely stabilise for the time being; they will receive little impetus from the fiscal support of the economy since this is taking place primarily in the form of additional public spending. As the expected recovery in the crisis economies of Southeast Asia sets in, so will their imports expand; a similar development will take place in Latin America in the latter part of the year. The OPEC countries will also expand their imports as their foreign exchange earnings increase in the wake of the marked rise in oil prices.

Figure 1
Development of Real World Trade in Goods¹



¹ Seasonally adjusted according to ASA II (HWWA-Version).

Sources: OECD; IMF; calculations by the Working Group on Foreign Trade and the HWWA.

Gradual Increase in Exports

Where exports are concerned, the regional divergences seen last year were far less pronounced than in the case of imports. Export growth in the industrialised countries slowed down considerably, and exports even fell temporarily – during the summer months in the USA, and in the last few months of last year in Japan and in western Europe. In Southeast Asia, however, the liquidity problems suffered by many companies and the implementation of comprehensive restructuring measures have meant that, despite a significant improvement in competitiveness as a result of currency devaluation, the crisis economies of the region have so far been unable to increase their exports to any substantial degree.

Exports from the transformation economies of eastern Europe have flattened out markedly, particularly as a result of the sluggish spell in the western European economy – their most important sales market – and the collapse of production in Russia. Altogether, however, exports from non-industrialised countries increased by 4½% last year compared to 1997 – one percentage point more than those from the industrialised countries.

As far as export developments are concerned, most regions probably put the worst behind them at the turn of the year. Exports increased again in all regions as the world economy recovered. Given a considerable negative overhang in most cases, however, growth rates for 1999 will still be lower than last year on the whole. Not until the year 2000 will they reach higher levels.

On the whole, the Working Group on Foreign Trade expects slower growth than most other institutes and international organisations, especially for this year with its forecast of a 2¾% increase in world trade. This is very little in comparison to the long-term average; during the period 1980 to 1998, annual growth averaged around 6%. This year's increase in world trade may appear relatively small in view of a long-term elasticity of just under 3 in relation to world production. However, this elasticity is not a constant, but fluctuates considerably and follows a clear pattern: in times of strong world economic activity it is greater, in periods of weakness it is lower than the long-term average. The fluctuations of elasticity are not least the result of the relatively high income elasticity of tradable goods – a reflection of the cyclical changes in industrial production which are quite pronounced compared to the development of real gross domestic product.

Falling Market Performance of Industrial Countries

Not only was there a marked decline in the industrialised countries' share of total exports last year, their export performance was also unfavourable. Thus export expansion in these countries remained almost one percentage point below the growth rate of their export markets. This is particularly true of Japan, where there was a loss of three percentage points. The main reason for this appears to have been the marked deterioration of Japanese companies' competitiveness compared with suppliers from the crisis economies of Southeast Asia. The export perfor-

Table 2
World Trade Volume

	Share of world imports 1998 in %	Imports			Share of world exports 1998 in %	Exports			Market performance ¹		
		1998	1999	2000		1998	1999	2000	1998	1999	2000
		Year-on-year change in %				Year-on-year change in %			Year-on-year change in %		
Western Europe	38.7	8.3	3.6	5.7	42.1	4.6	2.3	5.3	-1.0	-0.3	-0.2
USA	17.2	11.8	7.0	5.0	12.9	2.0	3.0	6.0	1.2	1.0	0.3
Japan	5.1	-5.7	1.0	4.0	7.3	-1.0	0.0	4.0	-3.0	-2.7	-1.5
Industrial countries	66.0	7.9	4.5	5.4	67.5	3.4	2.4	5.3	-0.9	-0.3	-0.3
Eastern Europe	4.9	7.0	-6.0	4.0	4.3	6.0	0.0	5.0	0.4	1.4	0.1
OPEC	2.7	-9.0	-5.0	5.0	3.6	2.0	1.0	3.0	0.7	-1.3	-2.4
Other countries	26.4	-5.0	0.0	6.0	24.6	4.5	4.0	6.0	0.7	0.7	0.6
Non-industrial countries	34.0	-3.6	-1.2	5.6	32.5	4.4	3.2	5.7	1.5	0.9	0.3
World	100.0	3.8	2.6	5.5	100.0	3.8	2.7	5.4	-	-	-

¹ Shift of market shares as the change in export volumes in relation to the development of regional export markets, in %.

Sources: OECD; IMF; calculations by Working Group on Foreign Trade.

mance of these countries is inadequately reflected in Table 2 because they are summarised along with many other emerging economies and developing countries as 'other countries'. Western Europe suffered a slight loss of market shares in its relevant export markets, probably caused to a large extent by lower price competitiveness. On the other hand it is remarkable to note that, in the trade group's estimation, the USA has actually gained market shares. This year and next, however, given relatively constant real effective exchange rates, there will be a general stabilisation of market shares.

The strong divergence of real goods imports in 1998 on the one hand and the comparatively slight divergence of real exports on the other have led to a drastic shift in trade balances. While a marked deterioration resulted for the industrialised countries, the foreign trade accounts of the non-industrialised countries were in surplus – although this was largely due to the collapse of imports; there has been little increase in exports.

World Trade Prices Rising Again

The effects of foreign trade on income developments in the various countries and regions are not only determined by the development of trade volumes, but also by the course of foreign trade prices. On a dollar basis, world trade prices fell by an average of 5¼% in 1998. There were, however, considerable differences in price developments for individual categories of goods. While prices for manufactured goods fell by only 2.5%, commodities became 15% cheaper. The fall was partly determined by the appreciation of the dollar compared to most other currencies. When adjusted to eliminate the effect of the dollar exchange rate, there has been little reduction in manufactured goods prices at all. With commodity prices falling, there was thus a considerable improvement in the industrialised countries' terms of trade (see Table 3).

In the course of this year, however, we will see a reversal in price trends. Since the OPEC decision taken last March to cut production, there has been an even stronger rise in crude oil prices than assumed in this forecast; nonetheless, it remains unlikely that the target price of \$18/b will be reached. On the whole, prices for other commodities will also increase during the rest of the year, although this is not yet apparent in the rates of change for the 1999 annual average – again due to the low level at the start of the year. Assuming that the exchange rate for the US dollar

changes little against the European currencies and remains more or less constant against the yen, dollar prices for manufactured goods will remain relatively stable. While these developments will lead to a marked deterioration in the industrialised countries' terms of trade, they will only partially reverse the pronounced improvement of real exchange relations which has taken place since 1996.

Last year, then, foreign trade had contrary effects on the development of domestic income in the industrialised countries. Dampening effects which resulted from the deterioration of their real foreign goods trade balance were largely softened by an improvement in their terms of trade. This, along with dampening influences on prices, has played a decisive role in strengthening domestic demand both in western Europe and, more especially, in the USA. In the non-industrialised countries as a whole, on the other hand, the unfavourable development of their terms of trade partially offset the supportive effect of foreign demand. The commodity-exporting countries in particular suffered a marked drop in export earnings as a result of the drastic fall in prices; moreover, the resulting deterioration of their balance of trade and also, in some cases, the decline in state income, led to demand-dampening monetary and fiscal policy measures.

With terms of trade for the non-industrialised countries developing more favourably again, this year and next will result in a relaxation of the foreign trade 'constraint'; and if economic weakness is overcome as expected there will also be a renewed increase in price-adjusted imports. As far as the industrialised countries are concerned, there will be little increase in the dampening effects resulting from foreign trade.

Table 3
World Trade Prices in National Currencies
(Year-on-year comparison in %)

	Average values for						Terms of trade		
	Exports			Imports					
	1998	1999	2000	1998	1999	2000	1998	1999	2000
Western Europe	-0.7	-0.8	0.7	-2.4	-1.0	0.8	1.7	0.2	-0.1
USA	-3.3	-2.0	-1.0	-6.0	-2.0	1.5	2.9	0.0	-2.5
Japan	1.0	-6.0	-1.0	-5.5	-8.0	0.0	6.9	2.2	-1.0
Industrial countries	-1.0	-1.6	0.1	-3.2	-1.6	0.9	2.3	0.0	-0.8
Eastern Europe	-5.6	-4.4	3.0	-3.1	-4.4	3.0	-2.6	0.0	0.0
OPEC	-27.0	-5.0	7.0	-4.0	-1.0	2.0	-24.0	-4.0	4.9
Other countries	-4.1	-4.4	2.0	-4.1	-3.5	1.0	0.0	-1.0	1.0
Non-Industrial countries	-0.4	-3.4	3.3	2.7	-1.9	2.3	-3.0	-1.6	-1.0
World	-0.8	-2.2	1.2	-1.3	-1.7	1.3	0.5	-0.5	-0.2

Sources: OECD; IMF; forecast by Working Group on Foreign Trade.

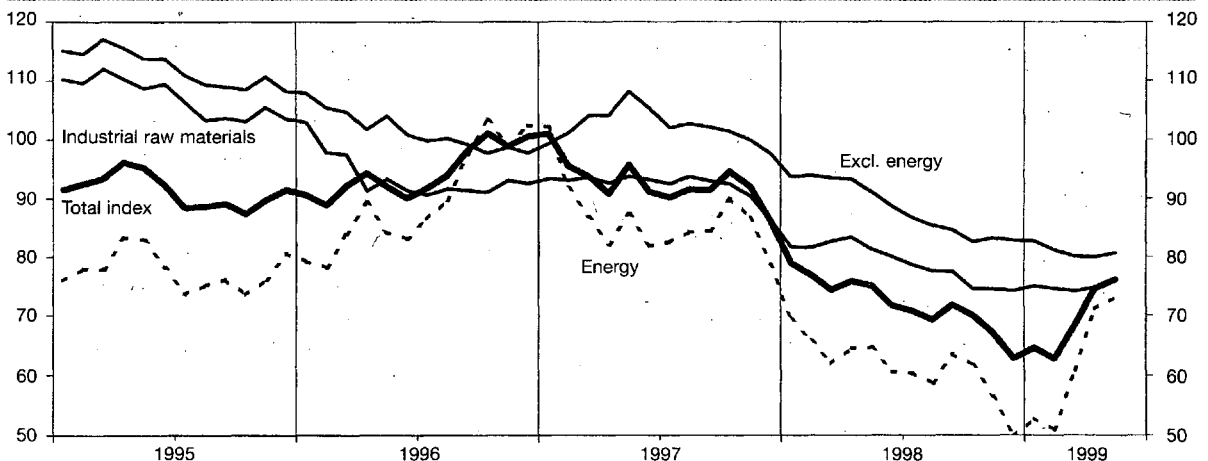
Threat of Protectionism?

Last year there were marked regional changes in balance of trade positions. There was a strong shift to positive balances among the emerging economies of Southeast Asia in particular. Despite a marked deterioration of their terms of trade for 1998, a swing took place in their current accounts – primarily determined by merchandise trade – from high deficits in 1997 to unusually high surpluses which, as a proportion of gross domestic product, ranged from 7½% in the Philippines to as much as 13½% in Thailand. At the same time, there was an increase in deficits in many Latin American countries, not least as a result of falling export prices and lower market shares due to poorer international competitiveness. Deficits in the transformation economies of eastern Europe also increased, albeit moderately. Altogether, there was a noticeable shift towards positive balances for the non-industrialised countries.

Among the industrialised countries there were considerable regional differences regarding the deterioration of trade balances. The USA carried the main burden: its 'traditional' trade deficit increased significantly – to 3% of gross domestic product – during the course of last year. While the European Union still managed to post a surplus which was only slightly below that of 1997, it fell rapidly in the second half of the year. Only Japan had a greater surplus than a year previously. The strong shift in balance of trade positions between the various countries and regions of the world, together with the uneven distribution of balance of trade deficits among the industrialised countries, could produce considerable trade political tension. In the US Congress, for example, there are an increasing number of voices calling for protectionist intervention. This, however, would be detrimental to the world economic recovery which has been assumed here for the world trade forecast.

HWWA Index of World Market Prices of Raw Materials¹

(1990 = 100)



Raw Materials and Groups of Materials ¹	1998	Nov. 98	Dec. 98	Jan. 99	Feb. 99	Mar. 99	Apr. 99	May 99 ²
Total Index	72.0 (-22.4)	67.0 (-27.0)	62.8 (-27.1)	64.6 (-18.2)	62.8 (-18.3)	68.4 (-8.1)	74.6 (-1.6)	76.1 (1.4)
Total, excl. energy	88.2 (-13.7)	83.2 (-16.6)	82.8 (-15.1)	82.7 (-11.7)	81.1 (-13.5)	80.0 (-14.3)	79.9 (-14.2)	80.6 (-11.5)
Food, tropical beverages	115.8 (-12.2)	109.0 (-14.7)	108.2 (-17.3)	105.5 (-18.3)	100.5 (-22.7)	97.4 (-22.3)	95.2 (-22.2)	94.8 (-21.1)
Industrial raw materials	78.9 (-14.5)	74.5 (-17.5)	74.2 (-13.9)	75.0 (-8.2)	74.6 (-8.6)	74.1 (-10.2)	74.8 (-10.2)	75.9 (-6.5)
Agricultural raw materials	79.3 (-14.4)	74.6 (-19.2)	75.8 (-13.6)	77.7 (-4.0)	78.3 (-3.9)	77.7 (-6.3)	77.1 (-8.1)	77.5 (-5.2)
Non-ferrous metals	71.1 (-20.8)	67.6 (-19.1)	64.6 (-18.1)	63.5 (-17.0)	63.3 (-15.5)	63.4 (-15.8)	67.2 (-11.6)	70.2 (-4.0)
Energy	61.4 (-29.0)	56.5 (-34.8)	49.7 (-36.8)	52.7 (-23.9)	50.8 (-22.8)	60.8 (-1.9)	71.1 (10.2)	73.1 (13.2)

¹ On a US dollar basis, averages for the period; figures in brackets: percentage year-on-year change.

² Up to and incl. 21st May.